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*Managing Director*

September 27, 2007

Dr. Russell Read  
Chief Investment Officer  
California Public Employees' Retirement System  
400 P Street, Suite 3492  
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Re: Global Equity Benchmarks (Agenda Item 7b)

Dear Russell,

You requested Wilshire's opinion regarding Staff's proposal regarding the new/revised benchmarks for the Global Equity program. We agree with the recommendations presented by Staff.

### **Market Weighting**

Staff has proposed shifting the target Global Equity benchmark from the current 66.7% US / 33.3% non-US split to a global market weighting, which is currently approximately 45% US / 55% non-US. Over the last several years, Wilshire's own internal research has shown a declining value from a "Home Country Bias" in clients' asset allocations, as the usual over-weight to domestic equities produces no additional return but may increase overall plan risk due to the concentration within a single asset class. As a result, many recent asset allocation studies performed for clients have pressed for a shift toward a country-neutral portfolio, weighted solely by market capitalization or GDP.

During this same time period, with the rapid increase in corporate globalization, such a shift toward a geography-neutral structure has recognized that national boundaries and corporate headquarters have become essentially meaningless from competitive and operational standpoints. The vast majority of the largest 1,000 companies in the world have a large share (or, in many cases, the majority) of their sales, manufacturing, operations, and/or personnel outside of their nominal country of domicile. As a result, to say that a Japanese auto manufacturer that builds more cars inside the US than anywhere else in the world is a purely Japanese investment, and therefore underweight this company relative to its true weight in the global economy (along with all other "non-US" companies), is potentially a misnomer, especially if we are simultaneously overweighting a US auto manufacturer on the basis of its US headquarters, even though much of its manufacturing is conducted in Canada, South Korea, and Mexico. Altering the structure of the portfolio to ignore what are increasingly artificial distinctions, as proposed by

Staff, will allow the portfolio to more fairly reflect the true global opportunity set of investments.

In addition, given that developed non-US markets and especially Emerging Markets are generally considered to be more inefficient than the US markets, the resulting increased weight to non-US stocks should offer more opportunities for value-added by active management than are currently possible in the portfolio.

### **Capitalization Extension**

Wilshire has always contended that the broadest measure of a market is the best measure of a market. Hence our endorsement over the years of the Lehman Aggregate Bond Index for use by most clients and our creation of the original Wilshire 5000 Index, now known as the Dow Jones Wilshire 5000 Index – the only stock market index to include every single publicly traded security in an equity market. Although we recognize that an extension into small and micro cap stocks should be made slowly, to minimize market impact and transactions costs, we fully support the idea of CalPERS expanding the opportunity set of available securities whenever possible.

### **Removing the REIT Prohibition**

REITs comprise a fairly small portion of the overall equity market capitalization, but can be a meaningful source of value-added. Since the Real Estate team invests only 10% of its assets in REITs, CalPERS has a built-in bias against REITs at the level of the entire portfolio. As a result, we believe that Staff's request to add REITs back in to the benchmarks has merit and should be approved.

### **Benchmark Data Providers**

CalPERS has used FTSE and Wilshire (now Dow Jones Wilshire) indexes as the broad international and domestic equity benchmarks for the international and domestic equity portfolios, respectively, for many years. Both providers are recognized as providing well-constructed benchmarks that are broadly representative of equity markets. In addition, both have demonstrated the ability to successfully customize the benchmarks to meet CalPERS specific needs (i.e. tobacco-free). Please note that Wilshire Associates no longer builds indexes. Dow Jones licenses Wilshire's name, and therefore Wilshire has no direct financial incentive to recommend the Dow Jones Wilshire indexes for use by CalPERS or any other client. In addition, Wilshire has already discussed the concept of the "normalization" process and we will work closely with Staff to develop a normalized global benchmark that fits CalPERS needs. The conversion of the existing benchmarks to the "Custom CalPERS" versions (i.e., excluding tobacco and REITs) is already included in Wilshire's current contract, as would be the "normalization" process.

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We look forward to working with you over the next few months in developing the policy and operational/investment structure for this new asset class, as well as in the asset allocation process.

If you have any additional questions, please do not hesitate to contact me.

Sincerely,

A handwritten signature in black ink, appearing to read "Russell Read", with a long horizontal flourish extending to the right.